***United States Court of Appeals***

***for the Second Circuit***

# INTERVENOR'S BRIEF

# 76-4054

## United States Court of Appeals
FOR THE SECOND CIRCUIT

RCA GLOBAL COMMUNICATIONS, INC.,
*Petitioner,*

*—against—*

FEDERAL COMMUNICATIONS COMMISSION and
UNITED STATES OF AMERICA,
*Respondents,*

*—and—*

ITT WORLD COMMUNICATIONS, INC.,
TRT TELECOMMUNICATIONS CORPORATION,
WESTERN UNION INTERNATIONAL, INC.,
*Intervenors.*

PETITION FOR REVIEW OF A REPORT, ORDER AND NOTICE OF PROPOSED RULEMAKING OF THE FEDERAL COMMUNICATIONS COMMISSION

# BRIEF OF INTERVENOR WESTERN UNION INTERNATIONAL, INC.


STROOCK & STROOCK & LAVAN
*Attorneys for Intervenor*
*Western Union International, Inc.*
61 Broadway
New York, New York 10006
212—425-5200

*Of Counsel:*
ALVIN K. HELLERSTEIN
HENRY J. SILBERBERG
ALAN KOLOD
—and—
ROBERT E. CONN
ROGER P. NEWELL
Western Union International, Inc.
One WUI Plaza
New York, New York
212—363-6404



249 Press of Fremont Payne, Inc. 417 Canal St., N. Y.—966—6570




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Docket No. 76-4054

# BRIEF OF INTERVENOR WESTERN UNION INTERNATIONAL, INC.

## PRELIMINARY STATEMENT

Intervenor Western Union International, Inc. ("WUI"), a common carrier of international

telegraph communications, joins in and adopts the arguments of petitioner RCA Global Communications, Inc. ("RCA Globcom") for review and reversal of a Report and Order and Notice of Proposed Rulemaking (the "Order") released by the Federal Communications Commission (the "FCC") on January 7, 1976.* In the Order, the FCC revoked the formula established under Section 222(e)(3) of the Communications Act, 47 U.S.C. §222(e)(3), by which The Western Union Telegraph Company ("Western Union"),** the sole domestic telegraph carrier, has since 1943 distributed international telegraph traffic among the international telegraph carriers (the "IRCs").

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*The Order is reported at 57 F.C.C.2d 190. Reconsideration of the Order was denied by the FCC in a Memorandum Opinion and Order released on September 27, 1976.

**Western Union and WUI are completely unrelated and independent companies.

## ARGUMENT

### POINT I

### THE FCC FAILED TO CONDUCT THE "FULL HEARING" REQUIRED BY LAW.

The section 222(e) provision for establishment of a formula to govern the distribution of international telegraph traffic is of fundamental importance to the IRCs. The formula was developed not only to protect against abuses by Western Union in distributing international telegraph traffic among the IRCs, but also to safeguard against predatory competition in an industry that traditionally has suffered from a static or declining market and an excess of capacity over demand. See Application for Merger, 10 F.C.C. 184, 191 (1943); Hearings Pursuant to S. Res. 95 Before a Subcomm. of the Senate Committee on Interstate Commerce, 77th Cong., 1st Sess. 91-97 (1941).

The formula determines the competitive structure of the industry. In promulgating any new formula, the FCC has the power to strangle an individual IRC by an unfair allocation or to throw the entire industry into a competitive chaos of the type that

required Congress in the 1940s to contemplate permitting the IRCs to merge into a single company.

When an agency is involved with issues of as great substantive importance as those presented by the revocation of the international formula, and is considering the adoption of new regulations that could dramatically alter the competitive structure of an entire industry, some kind of oral hearing with the possibility of evidentiary presentations, and something more than a routine notice-and-comment procedure, is appropriate. Natural Resources Defense Council, Inc. v. United States Nuclear Regulatory Commission, No. 75-4276 (2d Cir. May 26, 1976); International Harvester v. Ruckelshaus, 478 F.2d 615, 630 (D.C. Cir. 1973); Appalachian Power v. E. P. A., 477 F.2d 495 (4th Cir. 1973); Marine Space Enclosures v. F. M. C., 420 F.2d 577, 589 (D.C. Cir. 1969); Citizens for Allegan County, Inc. v. F.P.C., 414 F.2d 1125 (D.C. Cir. 1969); American Airlines, Inc. v. C.A.B., 359 F.2d 624 (D.C. Cir.) (en banc), cert. denied, 385 U.S. 843.(1966).

By failing to afford the statutory "full hearing" appropriate to the significance of the issues before it, the FCC "create[d] an injustice, instead of remedying one, by omitting to inform itself and by acting igno-

rantly when intelligent action [was] possible..." Isbrandtsen Co. Inc. v. U.S., 96 F. Supp. 883, 892 (S.D.N.Y. 1951), aff'd sub nom., Rederi v. Isbrandtsen Co. Inc., 342 U.S. 950 (1952). The FCC had a duty to represent the public interest by seeing to it that the record was complete and inquiring into and considering all relevant facts before making its determination, and it simply failed to fulfill that obligation by not conducting a full hearing permitting the introduction of evidence and oral argument. Scenic Hudson Preservation Conference v. F.P.C., 354 F.2d 608, 620 (2d Cir. 1965), cert. denied sub nom., Consolidated Edison Co., Inc. v. Scenic Hudson Preservation Conference, 384 U.S. 941 (1966). As a result, it revoked the existing formula without giving an intelligent explanation of its reasons or exhibiting any awareness of the possible consequence of its actions.

The conclusion that the FCC did not employ appropriate procedures is further compelled by reason of the statutory language of section 222(e) itself. Section 222(e) prevents the FCC from modifying the existing formula without first making specific findings that the existing formula is in particular respects "unjust,

unreasonable, or inequitable, or not in the public interest." While a trial-type hearing might not necessarily be appropriate as a prerequisite for promulgation of a new formula, it is implicit in the statute that any new formula promulgated by the FCC must be directed at eliminating the improper features of the existing formula. In short, section 222(e)(3) imposes the statutory obligation on the FCC to specifically identify an existing problem before it promulgates a solution.

Section 222(e) contains three separate subdivisions which impose upon the FCC the obligation to provide a hearing. Subdivisions (1) and (2) provide that in the event the interested carriers in 1943 had been unable to agree upon a formula for the distribution of international telegraph traffic, then the FCC, "after due notice and hearing," was empowered to prescribe such a formula. In contrast, subdivision (3) provides that once a formula pursuant to subdivisions (1) and (2) has been promulgated, changes thereof by the FCC are only permissible "after a full hearing." In other words, there is a distinct statutory difference between the kind of hearing needed in order to promulgate a formula

for the distribution of international telegraph traffic under section 222(e) and the hearing necessary to invalidate an existing and approved formula.

Indeed, the consistent practice of the FCC over more than three decades has been to recognize subdivision (3) of section 222(e) as a mandate for adjudicative proceedings wherein a record is created through the submission of evidence and an opportunity to cross-examine witnesses is afforded. For example, in its brief submitted in opposition to the motion by RCA Globcom to stay the effectiveness of the FCC Order pending a determination of this petition for review (at p. 15), the FCC acknowledged that it has utilized trial-type procedures under section 222(e)(3) to adjudicate complaints from Western Union regarding the lawfulness of its toll divisions with the IRCs. See, e.g., Western Union Tel. Co., 2 F.C.C.2d 892 (1966); Western Union Tel. Co., 25 F.C.C. 535 (1958). See also International Record Carriers' Scope of Operations, 43 F.C.C.2d 1069, 1071 (1974). The FCC nonetheless seeks to distinguish these other FCC proceedings, which the FCC has categorized as "classical adjudication re-

quiring resolution of a number of contested facts,"* and the proceeding here at issue. The discussion in POINT II, infra, shows that there is as much reason to use a trial-type procedure in the present case as in division of toll cases, and that there are numerous disputed factual questions requiring greater explanation than was possible in the "bare-bones" notice-and-comment proceeding that occurred in this instance.

The issues involved in toll division cases are similar, though not identical to, the issues in the present formula case. In both situations, the FCC is required to resolve a dispute among telegraph companies over the division of a limited amount of revenue. The toll division cases involve the distribution of customers' tolls between Western Union, on the one hand, and the IRCs on the other. Similarly, in the instant case, the FCC attempted to decide the proper division of revenues from international telegraph traffic among the IRCs.

Accordingly, because of the FCC's departure from its prior practice, no special weight can be placed on the FCC's current interpretation of section 222(e)(3),

*FCC brief on RCA Globcom's stay motion at p. 15.

United Housing Foundation Inc. v. Forman, 421 U.S. 837, 858 n. 25, reh. den. 423 U.S. 884 (1975), as might otherwise be the case, Red Lion Broadcasting Co. v. FCC, 395 U.S. 367, 381 (1969); Columbia Broadcasting System, Inc. v. Democratic National Committee, 412 U.S. 94, 121 (1973).

In addition, it is noteworthy that the statutory term "full hearing" has been considered by several courts as also requiring the trial-type hearing which WUI and RCA Globcom claim they were denied in this case. U.S. v. Storer Broadcasting Co., 351 U.S. 192 (1956) (Communications Act §309(a)); Morgan v. U.S., 298 U.S. 468 (1936) (Packers and Stockyards Act of 1921); Akron, C. & Y. Ry. Co. v. United States, 261 U.S. 184 (1923) (Interstate Commerce Act §15(6)).

Thus, all of the relevant signposts point to the conclusion that the FCC was obligated to make specific factual findings before invalidating the existing formula, and that some form of an evidentiary hearing should have preceded any attempt at making such findings.

## POINT II

### THE FCC ORDER LACKS ADEQUATE EXPLANATION, IS WITHOUT FACTUAL JUSTIFICATION, AND IS IRRATIONAL.

The FCC itself recognized that before it could promulgate any new formula, section 222(e)(3) required that it identify the defects in the existing formula. Thus, in its November 26, 1973 Order commencing the formula inquiry, the FCC specifically demanded information with respect to

> "the present defects in the formula, pointing out with specificity the effect of each claimed defect not only on the respondent, but also on other international record carriers and on the quality of service provided to and the rates charged the using public."

Yet, in its Order here under review, the FCC disclaimed any obligation to make specific factual findings on any defects in the existing formula. It stated, "We are not concerned here whether or not a party can quantify the negative impact of the formula." Order, ¶24. The FCC was equally unconcerned with whether it could even identify the supposed "negative impact." In the FCC's current mind, it was sufficient to find a "possibility that quality service could have been improved absent

the inequities of the formula." Order, ¶24.

A. Overages and Deficiencies.

The major so-called defect in the existing formula identified by the FCC is the accumulation of overages and deficiencies. These accumulations have been known to exist for many years and, indeed, the mechanism for the accumulations was deliberately established by the International Quota Bureau with the FCC's acquiescense. The accumulations simply demonstrate that there has not been a sufficient amount of unrouted telegraph business available for the purpose of insuring that each of the IRCs obtains its allocated share of the total international message telegraph market. Because of a decrease in the number of unrouted messages, some carriers have been receiving less than the market share of traffic to certain points that the FCC and the IRCs had originally agreed they were equitably entitled to. The deficiencies and overages in themselves, as the FCC at one point recognized, are without "any independent legal significance." Order ¶22.

Why the FCC found the accumulation of overages and deficiencies to be per se objectionable is incomprehensible. The FCC did not challenge the justness or the equity of the allocation established in 1943 by the formula. Presumably, if there were sufficient unrouted traffic to satisfy the allocations and eliminate overages and deficiencies, the FCC would find the formula just and equitable. The position of the FCC seems to be that, although it was originally agreed that each of the IRCs is entitled to a portion of the unrouted traffic in order to bring its market share to a certain level, the fact that there are insufficient amounts of unrouted traffic available to fully achieve the goal makes it irrational to attempt to achieve the goal at all. The FCC never explains (as it should have) why it is irrational to do the best that can be done to achieve an equitable distribution, even if full and complete equity cannot be achieved.

B. Alleged Disincentives to Better Service.

Aside from the FCC's misconceived view of the nature of overages and deficiencies, the FCC identified the accumulations with the balancing provision of the

formula and alleged that these features create disincentives to better service by penalizing the competitively successful IRCs. Order ¶43.

These disincentives occur, the FCC presumes, as a result of the fact that for a very few destination areas, an increase in the number of routed messages that a particular carrier receives at one of those particular destination areas will result in a corresponding reduction in the number of unrouted messages to that area. Therefore, the FCC supposes, such a carrier has no incentive to improve its service so as to capture more routed traffic.* This conclusion is fallacious for three reasons:

1. Only 15% of all outbound traffic is subject to this balancing provision. Order,

*This point is at the heart of the FCC's finding that the present formula is defective. As the FCC noted in its September 27, 1976 Order (at ¶10): "[W]e explicitly stated that the purpose of revising the distribution formula was to minimize any disincentives to carrier-initiated improvements in quality of service and to maximize the possibility of future benefits in this regard. 57 FCC 2d at 202. Having found that the original formula provided no incentives for the IRC's to improve service or increase efficiency, our obligations under the mandate of 47 U.S.C. §151 dictated that we adopt a formula which does provide such stimuli. 57 FCC 2d at 208."

¶19. 85% is destined to areas for which one carrier already receives all unrouted traffic, and will continue to do so until its deficiency for that area is eliminated. The effect of a deficiency is to create a limited exception to the balancing provision by permitting an IRC to compete for all routed traffic without suffering any offsetting loss of unrouted messages. A carrier with an overage can also compete fully because it is not receiving any unrouted messages which can be taken from it. Thus for the overwhelming majority of areas, no carrier loses any unrouted traffic by virtue of increasing its routed traffic. There is thus no disincentive to better service for at least 85% of the traffic.*

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* In attempting to deal with this argument, the FCC noted that it was "reasonable on its face", but replied that it "ignores the fact that the reason little traffic is subject to proportionate distribution is that for most destinations one carrier receives all unrouted traffic." (Order ¶23). This is nonsensical. The fact which the FCC accuses WUI of ignoring is the very fact upon which WUI's argument is founded.

2. Even for those areas in which there is proportioned distribution of unrouted traffic, as a practical matter no such disincentive can operate. As would have been demonstrated in an evidentiary hearing, the computerized operations of all of the IRCs require them to provide an identical grade of service to all destination areas. Any improvements in service that a carrier implements must of necessity benefit traffic to all destinations.

3. With regard to the 15% of the traffic on which the balanching provision does operate, its effect, if any, is not to penalize competitive efforts, but rather to channel the IRCs competitive efforts into the solicitation of the unrouted traffic. Under the balancing provisions, if a carrier diverts existing customers from its competitors, it would indeed lose a corresponding amount of unrouted traffic. On the other hand, an IRC that is successful in converting previously unrouted messages into routed mes-

sages, could increase its overall market share despite the balancing. The FCC failed to understand this, and in any event, there was insufficient evidence before the FCC for its conclusion that the balancing provision operates to prevent competition.

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In sum, had the FCC taken hard evidence on these issues, it would have discovered that the operation of the present formula results in increasing overages and deficiencies not because it discourages competition, but rather <u>despite</u> the fact that the overages and deficiencies encourage competition. The overages and deficiencies continue to exist because the IRCs simply have been unsuccessful in effecting significant traffic shifts from their competitors. Had the FCC recognized this point, it might then have asked itself whether there is any public benefit to be gained from further encouraging the IRCs to expend funds on what has been an unfruitful effort to raid their competitors'

customers. Because of the FCC's failure to make an adequate factual investigation of the operation of the formula, it confused the theoretical effect of the balancing provision, which discourages raiding, with the very different actual effect of the provision for the accumulation of overages and deficiencies from year to year, which encourages raiding.

Although the FCC promulgated the interim formula on the assumption that under it "the carriers will be encouraged to seek specific routings from customers," it is evident that the interim formula will only further encourage raiding activities and discourage entirely the expenditure of money on the conversion of unrouted messages into routed messages. Under the interim formula, if an IRC is able to take routed messages from its competitors, then it will also receive an equal proportion of the revenues from unrouted messages. As ITT Worldcom itself recognizes, each decision by a customer to route via a particular carrier will carry with it not only the revenues to be earned from that customer's message but also the

revenues from a corresponding share of the unrouted message market.* The FCC never explains why it can be expected that an IRC will spend money to convert unrouted messages into routed messages, when it can achieve the same effect, plus gain additional revenue, by taking already routed messages from its competitors.** The FCC's interim formula not only encourages such raiding activity, while discouraging competitive solicitation for unrouted messages, but it will supply ITT and TRT with an immediate windfall of approximately $2,000,000 in revenues that can be devoted to such raiding. The FCC appears to have regarded the interim formula as a step towards a system requiring the specific routing of traffic and, accordingly, it justified its choice of the interim formula on the ground that it is a preliminary step towards a desirable end.

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*ITT Worldcom brief on RCA Globcom's motion for a stay, p.30.

**This can be demonstrated mathematically. E.g., In a universe of 10 messages, 5 each of routed and unrouted, if a carrier with 1 of the routed messages can take an additional routed message from a competitor, it will have 2 routed messages and be entitled to 2 unrouted messages. If the same carrier solicits an unrouted message, it will have 2 of the 6 routed messages and will be entitled to 2/6ths of the 4 unrouted messages, or 1 1/3 messages, instead of 2.

But assuming, arguendo, that the FCC's contemplated final solution is desirable, the FCC failed to understand that the interim formula could have consequences unrelated to and far more drastic than those which would occur under a system of required routings. This is significant because it will undoubtedly be a long time before the FCC determines whether requiring routing is practicable, and the FCC may ultimately conclude that it is not. The interim formula will encourage competition in the form of raiding even much more than would a simple requirement that all messages be routed. Putting aside the possible difficulties that would result in a regime of all routed messages, it is clear that under that regime, each IRC would have no more than its present incentive to compete for existing routed traffic plus the additional incentive to solicit unrouted messages. By amplifying the revenues to be gained through the diversion of traffic, however, the interim formula will encourage even more raiding among the IRCs for each other's routed traffic. Nothing in the

Order suggests that the FCC considered the implications of this or found it to be a desirable result.

The FCC's reasoning simply does not hold together. It is evident that if the FCC had conducted the requisite hearing, as discussed above, it would have been better informed as to the relevant facts and might have been in a position to reach a reasoned judgment founded upon an accurate conception of the competitive structure of the international telegraph industry.

## CONCLUSION

The FCC Order should be vacated and set aside.

Respectfully yours,

STROOCK & STROOCK & LAVAN
Attorneys for Intervenor,
Western Union International, Inc.
61 Broadway
New York, New York 10006
(212) 425-5200

Of Counsel:

ALVIN K. HELLERSTEIN
HENRY J. SILBERBERG
ALAN KOLOD
-and-
ROBERT E. CONN
ROGER P. NEWELL
Western Union International, Inc.
One WUI Plaza
New York, New York 10004
(212) 363-6404

CERTIFICATE OF SERVICE

I, Alan Kolod, hereby certify that two copies of the foregoing "Brief of Intervenor Western Union International, Inc." were served by mail this 29th day of October, 1976, on the following persons at their addresses below:

Cahill, Gordon & Reindel
Attn: H. Richard Schumacher
80 Pine Street
New York, N.Y. 10005
Attorneys for Petitioner
RCA Global Communications, Inc.

Jack D. Smith, Esq.
Office of General Counsel
Federal Communications Commission
1919 M Street, N.W.
Washington, D.C. 20554
Attorney for Respondent
Federal Communications Commission

Hon. David I. Baker
Assistant Attorney General
U. S. Department of Justice
Washington, D.C. 20531
Attorney for Respondent
United States of America

LeBeouf, Lamb, Leiby & MacRae
Attn: Charles P. Sifton, Esq.
140 Broadway
New York, N.Y. 10005
Attorneys for Intervenor
ITT World Communications Inc.

Covington & Burling
Attn: Edward Bruce, Esq.
888 16th Street, N.W.
Washington, D.C. 20006
Attorneys for Intervenor
TRT Telecommunications Corporation

Alan Kolod